

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:NER:MAN:TL-N-6752-99
KVDoce

date:

to: Chief, Appeals Division, Manhattan District
Attention: Frank Bak

from: District Counsel, Manhattan District, New York

subject: Request for Legal Advice

SSN: [REDACTED]

S/L: [REDACTED]

DISCLOSURE STATEMENT

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ISSUES

1. Whether a charitable contribution carryover deduction, taken in a year barred from assessment by the statute of limitations, can be used to adjust the taxpayers' charitable contribution deduction in the open year under audit.
2. Whether the carryover of a charitable contribution deduction from an open year ([REDACTED]) to a closed year ([REDACTED]) renders the closed year open for assessment purposes.

FACTS

In a bargain sale transacted in [REDACTED], the taxpayers sold a [REDACTED] to the [REDACTED] for \$ [REDACTED]. [REDACTED] appraised the boat for the taxpayers and valued the [REDACTED] for the amount of \$ [REDACTED]. The taxpayers claimed a charitable contribution deduction in the amount of \$ [REDACTED], calculated by subtracting the bargain sale amount from the appraisal value amount, for the taxable year [REDACTED]. Pursuant to the [REDACTED] % charitable contribution limitations of I.R.C. §170, the taxpayers deducted \$ [REDACTED] of the boat's value as a charitable contribution in the taxable year [REDACTED] and carried over and deducted the remaining \$ [REDACTED] in the taxable year [REDACTED].

An audit of the taxpayers' [REDACTED] tax return was performed and the value of the boat for charitable contribution purposes was questioned. A referral was made by the examiner to the District's engineering and valuation section. The District's expert appraised the boat for the amount of \$ [REDACTED]. The exam agent determined the allowable charitable contribution deduction to be \$ [REDACTED] by reducing the \$ [REDACTED] value by the bargain sale price of \$ [REDACTED]. The exam agent proposed a charitable contribution adjustment in the amount of \$ [REDACTED] (\$ [REDACTED] - [REDACTED]) for the taxable year [REDACTED].

The case was sent to Appeals for consideration because the taxpayers did not agree with the examiner's findings regarding the boat's appraised value. The appeals officer reached an agreement with the representative of the taxpayers that the allowable deduction was \$ [REDACTED]. Accordingly, that agreement reduced the District's adjustment in the amount of \$ [REDACTED] by \$ [REDACTED]. This settlement results in no adjustment for the taxable year [REDACTED] since the taxpayers only claimed a deduction in the amount of \$ [REDACTED] instead of the allowable amount of \$ [REDACTED]. In addition, the settlement results in a carryover to [REDACTED] in the amount of \$ [REDACTED]. However, as the taxpayers deducted the amount of \$ [REDACTED] on their return for [REDACTED], the settlement results in a proposed adjustment of \$ [REDACTED] in that time barred year.

The appeals officer informed the taxpayers' representative that his adjustment was predicated upon disallowing a portion of the taxpayers' [REDACTED] taxable year contribution carryover by bringing it back into the [REDACTED] taxable year. The taxpayers' representative disagreed because the [REDACTED] year is barred by statute. We understand for the purposes of this advice that no provision of §6501 applies to the [REDACTED] taxable year.

DISCUSSION

1. The IRS cannot disallow the \$ [REDACTED] carryover from the barred [REDACTED] taxable year by including it in the open [REDACTED] taxable year adjustment.

Respondent generally must assess tax against an individual taxpayer within 3 years after the later of the due date or filing date of his or her return. I.R.C. §§6501(a) and (b)(1); Centennial Sav. Bank FSB v. United States, 887 F.2d 595, 598 (5th Cir. 1989), *aff'd in part and rev'd in part on other grounds*, 499 U.S. 573 (1991). However, it is well settled that the IRS and the courts may recompute taxable income in a closed year in order to determine tax liability in an open year. Barenholtz v. United States, 784 F.2d 375, 380-381 (Fed. Cir. 1986) (citing Springfield St. Ry. v. United States, 312 F.2d 754, 757-59 (Cl. Ct. 1963)). Section 6501(a) bars assessments but not examinations, calculations, or adjustments. See *id.* at 380-381; see also Angell v. Commissioner, T.C. Memo. 1986-528, *aff'd without published opinion*, 861 F.2d 723 (7th Cir. 1988). Therefore, the IRS is free to examine items that appear on a return for a year that is closed for assessment purposes, provided the items affect taxable years remaining open for assessment purposes. See Angell, T.C. Memo. 1986-528.

Furthermore, §6501 authorizes the IRS to examine barred years for the purpose of redetermining the net operating loss (NOL) deduction for a current year. See, e.g., Leitgen v. Commissioner, 691 F.2d 504 (8th Cir. 1982), *aff'g without published opinion* T.C. Memo. 1981-525; Hill v. Commissioner, 95 T.C. 437, 439-440 (1990); Lone Manor Farms, Inc. v. Commissioner, 61 T.C. 436, 440-441 (1974), *aff'd without published opinion*, 510 F.2d 970 (3d Cir. 1975). The Tax Court has determined that the IRS may adjust a taxpayer's charitable contribution carryover deduction for the same reason that he may adjust a NOL carryover deduction. See Mecom v. Commissioner, 101 T.C. 374, 394 n.24 (1993), *aff'd without published opinion*, 40 F.3d 385 (5th Cir. 1994).

In addition, I.R.C. §6214(b) provides that the Tax Court may redetermine a deficiency in a given year by considering facts related to taxes in other years. Such a redetermination of taxable income in a prior closed year is allowed solely for the purpose of determining the correct taxable income in a current year. I.R.C. §6214(b). Therefore, the Commissioner is only allowed to assess a deficiency for an open year where his determination does not concern additional assessments for the barred year. See Calumet Industries, Inc. v. Commissioner, 95 T.C. 257 (1990).

However, our review of the applicable authorities failed to discover any authority supporting the action contemplated by the appeals officer - that is, including the time barred disallowable charitable contribution deduction to increase the amount of the adjustment to the charitable contribution deduction in the open year. Accordingly, the IRS, in adjusting the taxpayers' [REDACTED] charitable contribution deduction, may take into account their [REDACTED] charitable contribution carryover deduction. However, the IRS cannot disallow the \$ [REDACTED] carryover distribution in the barred [REDACTED] taxable year by disallowing it in the [REDACTED] taxable open year.

2. The carryover of a charitable contribution deduction from an open year ([REDACTED]) to a closed year ([REDACTED]) does not render the closed year open for assessment purposes with respect to the open year item.

Section 6501(a) provides the general rule that the amount of any tax imposed by the Internal Revenue Code shall be assessed within 3 years after the return was filed, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of that period. Section 6501 also provides numerous, nonexclusive exceptions to the general 3-year limitations rule which extend, sometimes indefinitely, the period within which respondent may assess a tax. One such exception is contained in section 6501(h), which provides that "In the case of a deficiency attributable to the application to the taxpayer of a net operating loss carryback . . . , such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the net operating loss . . . which results in such carryback may be assessed." In other words, if the year in which the NOL arose is open, then the year to which the NOL is carried back is also open for purposes of assessing a deficiency attributable to the carryback. See also §6501(m). Section 6501(h) effectively extends the assessment period for a deficiency that is based on the specific disallowance of an erroneous or improper net operating loss carryback until the assessment period for the tax year creating the loss has expired.

Therefore, it has long been held that the Commissioner may recompute the correct amount of a taxpayer's income for a closed year, whether or not the assessment of a deficiency for that year is barred, where such computation was for the purpose of ascertaining the correct amount of a net operating loss carry over or carry back was available for an open taxable year. See Lone Manor Farms, 61 T.C. at 440. However, the extended period for assessment of deficiencies under section 6501(h) applies only to deficiencies attributable to NOL carrybacks and not other

items. See Davis v. Commissioner, T.C. Memo. 1999-250 (1999) (citing Bouchev v. Commissioner, 19 T.C. 1078, 1081 (1953)).

CONCLUSION

1. The IRS cannot use the \$ [REDACTED] carryover distribution from the [REDACTED] taxable year barred by statute to increase the amount of the disallowed deduction in the open [REDACTED] taxable year.
2. The carryover of a charitable contribution deduction from an open year ([REDACTED]) to a closed year ([REDACTED]) does not render the closed year open for assessment purposes.

The administrative file is being returned herewith. If you have any questions concerning this matter, please call Keith Doce at (212) 264-5473.

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By: _____
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